OPEN MEETING AGENDA ITEM

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AZ CORP COMMISSION
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January 13, 2003

Arizona Corporation Commission
DOCKETED

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DOCKETED BY

Chairman William A. Mundell
Commissioner Jim Irvin
Commissioner Marc Spitzer
Commissioner Jeff Hatch-Miller
Commissioner Mike Gleason
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85012

RE: Application for Approval of the Transfer of Control of XO Long Distance Services, Inc. and XO Arizona, Inc. (Docket Nos. T-04150A-02-0814, T-03775A-02-0814, T-03601A-02-0814) – Agenda Item U-2.

Dear Commissioners:

This letter supplements the Application for Approval of Transfer of Control filed by XO Communications, Inc. on October 28, 2002 (the "Application"). The Application is scheduled to be considered by the Commission at the January 15, 2003, open meeting.

1. XO

XO Arizona, Inc. and XO Long Distance, Inc. are wholly owned subsidiaries of XO Communications, Inc. ("XO") providing service in Arizona. Through its operating subsidiaries, XO provides bundled local and long distance as well as dedicated voice and data telecommunications services to customers in Arizona and in many other states. XO currently serves approximately 1,625 Arizona business customers. XO operates two offices in Arizona (see Exhibit A) and employs approximately 80 people.

XO is one of a small number of companies that has invested in, rather than simply leased, Arizona telecommunications facilities to compete with the incumbent telephone service provider, Qwest Communications. XO has invested $54.4 million in Arizona to build its network and grow its operations. An XO fiber optic ring encircles the Phoenix metro area, bounded by Camelback to the north, Elliot to the south, Pima/Price Road to the East, and 7th Avenue to the

west. This network does not reach everywhere and, therefore, XO also provides service to many customers by way of facilities leased from Qwest. XO is well-positioned, if given the opportunity, to add customers, broaden its range of available services, and provide more telecommunications options for Arizona consumers.

For the past few years, XO has experienced many of the same financial challenges facing the competitive telecommunication industry as a whole. On June 17, 2002, XO sought the protection of the Bankruptcy Court and since that time has operated under the Court's supervision. The XO subsidiaries operating in Arizona, XO Arizona, Inc. and XO Long Distance, Inc., did not file for bankruptcy but obviously are affected by the bankruptcy of their parent. The Application before the Commission reflects XO's plan for emerging from bankruptcy and has been approved by the Bankruptcy Court. The plan calls for the elimination of half of XO's secured debt, the elimination of its unsecured debt, the cancellation of existing equity and the issuance of new stock to various classes of creditors. A majority of the shares of the reorganized XO will be held by High River Limited Partnership ("High River") and other entities affiliated with Carl Icahn and those entities will have control over XO. It is this change of ownership of XO that is the primary focus of this proceeding. Although there will be new ownership at the parent level, XO's operating subsidiaries in Arizona will continue to operate much as they have in the past with the same services and under the same tariffs.

Because XO is a national company, its restructuring plan and the transfer of control has been subject to review by the Federal Communications Commission, the Department of Justice and numerous other state utility commissions. The plan has been approved by the Bankruptcy Court and all required regulatory approvals other than Arizona's have been received without significant conditions or qualifications. Awaiting the approval of this Commission, XO has delayed final consummation of the proposed transactions and XO's emergence from bankruptcy.

2. Background

This is the second restructuring plan presented to the Commission. On August 20, 2002, the Commission approved a prior plan which was similar in many respects but involved the issuance of new equity to entities associated with Forstmann Little, an investment firm, and Telmex, the Mexican telephone company, each of whom would hold approximately 40% of the restructured company's stock. The plan now before the Commission was an alternative to the earlier plan and when the parties decided that the Forstmann Little/Telmex plan would not be implemented, XO sought approval for the plan now before the Commission. The need to seek approval twice has delayed the company's emergence from bankruptcy which is why it is so important for this Commission to act on the pending request as soon as possible.

The asserted basis for the Commission's jurisdiction over this transfer of control transaction is the Public Holding Companies and Affiliated Interests Rules (the "Affiliated Interest Rules"), A.A.C. R14-2-801-806, which were adopted by the Commission in 1992 to establish a process for the Commission to use in evaluating how and when a public utility could

enter into a business transaction with an unregulated affiliate.[1] The Affiliated Interest Rules are very broad and on their face require Commission approval whenever a utility or affiliate intends to "reorganize" an existing public utility holding company. A.A.C. R14-2-803. "[R]eorganize" is defined to include "[t]he acquisition or divestiture of a financial interest in an affiliate or a utility, or reconfiguration of an existing affiliate or utility's position in the corporate structure or the merger or consolidation of an affiliate or a utility." A.A.C. R14-2-801(5). This means that whenever a parent company gains or loses investors, invests additional money in an existing subsidiary (even a non-utility subsidiary in a state other than Arizona) or participates in any sort of intracorporate merger, reconfiguration, or consolidation, Commission review and possible approval is required.

Because the universe of transactions captured by the Affiliated Interest Rules is so broad, the Commission attempted to temper their reach by reserving ample authority to grant waivers: "The Commission may waive compliance with any of the provisions of this Article upon a finding that such waiver is in the public interest." A.A.C. R14-2-806(A). Indeed, if the Commission fails to act on a waiver application within 30 days, the waiver automatically becomes effective. Once a company obtains a waiver it is able to "reorganize" without Commission approval provided threshold conditions set forth in its waiver order are not triggered. While the terms and the scope of these waivers have varied over the years, limited waivers were generally available to telecommunications companies. For example, in March of 2002, the Commission issued an order reaffirming for Qwest the limited waiver previously granted to US WEST in 1992. Pursuant to this waiver, Qwest need apply for approval of a transaction under the Affiliated Interest rules only if the proposed transactions is "likely to 1) result in increased capital costs to USWCI; 2) result in additional costs allocated to the Arizona jurisdiction; or 3) result in a reduction of USWCI's net operating income." With respect to all other affiliate transactions, Qwest need not seek Commission approval. This limited waiver, which is attached as Exhibit B, has not been amended or rescinded.

On December 11, 2001, XO applied for a limited waiver of the Affiliated Interests Rules. In May of 2002, the Commission denied that application, citing concerns that the Commission was uncertain of its ability to grant waivers without examining each affiliate transaction. Despite these concerns the Commission did nothing to rescind or revise limited waivers held by Qwest and other telecommunications providers. In June of 2002, XO sought reconsideration of the Commission's refusal to grant the waiver request and, in the alternative, sought approval of the restructuring involving Forstmann Little and Telmex discussed above. On August 20, 2002, the Commission again denied the waiver request, but approved the proposed transaction. As noted above, by agreement of the parties, the transaction approved at the August 20, 2002 open meeting was not implemented, and on October 28, 2002, XO filed a new application for approval of the alternate "stand-alone plan."

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[1] XO does not here concede that the Commission has jurisdiction under the Affiliated Interest Rules to review and approve this proposed restructuring. The origin of the rules and their very terms indicate that they could not properly be applied to competitive telecommunications companies such as XO and its subsidiaries. To the extent the rules would affect the actions of multi-state holding companies such as XO they may effectively impose an unconstitutional burden on interstate commerce.

3. The Commission Should Approve This Application

This Application seeks approval of a transaction that is national in scope. XO can only emerge from its current bankruptcy proceeding through a restructuring. Every other federal and state regulatory approval necessary to close this restructuring has been obtained, including all required approvals from the Federal Communications Commission, the U.S. Department of Justice and all other state commissions. Approval of this transaction will be good for XO's Arizona employees, customers, and prospective customers.

On December 17, 2002, the Commission considered, but did not rule on, XO's Application. Since that meeting, High River, which is ultimately controlled by Carl Icahn, provided the letter attached as Exhibit C expressing Mr. Icahn's clear intentions to operate XO as a successful and innovative competitive telecommunications company, which will give customer service the highest priority. In addition to the assurances offered by High River, XO offers the following information demonstrating that approval of its Application will clearly foster competition and serve the public interest.

a. XO Operates in a Competitive Market

XO, through its operating subsidiaries, sells telecommunications products to customers who already have a choice of vendors. Unlike Qwest, XO is not a carrier of last resort. If XO does not deliver the right product at the right price, its customer will return to Qwest or seek out another provider. The rates of competitive carriers such as XO are determined by the value of the services they offer and pricing of their competitors. While a customer of a monopoly provider might have to suffer without recourse old equipment, poor maintenance, inconsiderate service agents, poor service quality, or high prices, consumers in a competitive market are not so constrained. As a customer of a competitive carrier, XO's customers can leave and take their business elsewhere. While the Commission may need to use rigorous oversight in protecting consumers from a monopolist or near-monopoly provider, the same level of oversight is unnecessary for competitive providers. Competition – and the attendant push to earn and keep customers -- will protect consumers and ultimately cause the production of more value (products, services, features) for less money. In recognition of the foregoing, competitive carriers have generally been subjected to a significantly reduced level of regulation compared to other, more traditional, monopoly utilities.

Unfortunately, the competitive market for telecommunications providers is shallow and spotty in Arizona. More telecommunications carriers have gone out of business in the past year than have succeeded. Fewer than a dozen facilities-based carriers provide service to business customers. If the Commission forces XO to leave the Arizona market (the only alternative we see if this restructuring is not approved), one of largest investors in facilities-based competition in Arizona will be gone. XO's Arizona customers will certainly not be better off if XO is forced to discontinue service. Similarly, the general public will lose all of the advantages attendant to the development of local competition if Arizona loses yet another facilities-based service provider.

The Affiliated Interest Rules were never meant to apply to competitive local exchange and interexchange companies subject to market forces and competition. The Rules were enacted in response to a diversification movement by Arizona's electric utilities into areas such as savings and loan companies and hotel investments. At the time of the adoption of the Rules, there was no competitive pricing for electric companies and no competition for the provision of electric service to customers. In adopting the Rules, the Commission was attempting to protect captive customers of the monopoly utilities from having to bear the costs of such non-utility investments. See Arizona Corp. Comm'n v. State ex rel Woods, 171 Ariz. 286, 289-290, 830 P.2d. 807, 810-811 (1992). In a competitive market there is no need to protect consumers from the temptations visited on a utility with a captive group of customers. That situation simply does not exist for a provider that is prevented, by the competitive market, from passing on to customers affiliate losses. On the other hand, a key goal of the Affiliated Interest Rules – making investment dollars available to regulated utilities – favors approval of this Application.

b. Approval of This Application Will Increase Consumer Protection

This Commission has expressed its commitment to protecting consumers. In connection with its Application, XO has agreed to conditions proposed by staff that will protect and benefit Arizona consumers. First, XO has agreed to post a bond in the amount of $235,000 to protect its customers in the event XO ceases operations in Arizona. Currently, there is no such bond requirement. Second, XO has agreed to give customers at least 90 days' notice prior to discontinuing service in the event XO ceases providing service in Arizona. (XO is not otherwise required by state law to give customers 90 days' notice.)

Finally, XO has expressed its willingness to not increase the maximum rates and prices it currently has on file with the Commission for one year and increase rates in the second year only based on competitive market conditions or changes. This is an unprecedented concession by XO given that its ability to successfully compete in Arizona is impaired if it cannot react to changes in the competitive environment. XO's costs to provide service increase regularly. For example, last month Qwest increased the price of its private line product by 15%. XO must pay this rate to remain interconnected to Qwest and its customers. If XO is prohibited from flowing through all, or a portion, of this increase to customers, it will lose money on the service. XO has agreed to assume this risk – and these costs – as a condition of the restructuring. Because Qwest has complete pricing flexibility for competitive services, XO cannot effectively compete with Qwest if Qwest can adjust prices without restriction and XO is prevented from adjusting its prices. While we question whether this condition truly serves the public interest, XO has agreed to accept it.

These three conditions are in addition to the other five conditions included in the Staff proposed amendment filed with Docket Control on Friday, January 10, 2002. All eight of the conditions proposed by staff and agreed to by XO are perceived by the Commission to benefit Arizona consumers.

c. The Commission has Ongoing Oversight

Presuming the Commission approves this Application, the Commission will have ongoing oversight authority with respect to XO Arizona operations. Under A.R.S. § 40-285, XO cannot "sell, lease, assign, mortgage, or otherwise dispose of or encumber . . . its . . . plant, or system necessary or useful in the performance of its duties . . . without first having secured from the commission an order authorizing it to do so." This means XO cannot sell, or change how it owns, its Arizona assets without Commission approval.

Similarly, this Commission has authority to monitor service quality, enforce service quality standards and investigate customer complaints. XO Arizona is proud of its service quality record in Arizona, and recognizes that its superior commitment to customer care is critical to continued growth. Nonetheless, if a service problem emerges, the Commission will have authority to investigate any complaint.

In sum, XO Arizona will continue to be, after the restructuring, an Arizona public service corporation subject to the jurisdiction and oversight of the Arizona Corporation Commission. The Commission will have ample opportunity to address future concerns or issues if they materialize.

d. Investor Incentives

Carl Icahn's companies have invested approximately $500,000 to acquire their interest in XO Communications primarily through the purchase of secured bank debt and notes. This investment makes sense only if XO Communications, Inc. grows and continues to be a successful provider of telecommunications services by offering innovative products and competitive prices. Indeed, given the market for telecommunications assets, the liquidation value of XO's assets is a tiny fraction of its potential value as an operating and successful concern. With the elimination of much of its prior debt and improved access to future funding, XO has every reasonable expectation of becoming successful. Accordingly, to protect and assure a return on his investment, Carl Icahn has every incentive to operate a strong and healthy competitive provider of telecommunications service. If the Commission approves XO's Application, XO can complete its reorganization and emerge from bankruptcy with a strong balance sheet and financial stability. This, in turn, will allow the company to provide Arizona consumers and its customers nationwide with a wide range of local and long distance services at competitive prices.

4. Conditions Proposed by Staff

On Friday, January 10, 2003, staff filed an amendment to the original order in this docket. To obtain approval of the restructuring, XO will support all of the conditions included in this amendment.

5. XO Needs a Prompt Decision

For over a year, XO and staff have worked cooperatively with the understanding that a parent company restructuring was inevitable. XO requested a wavier of the Affiliated Interest Rules believing that surely a CLEC would be entitled to (at minimum) the waiver Qwest had been issued. When the waiver request was denied, XO worked to obtain all necessary Arizona approvals. XO cannot delay further the closing of this national restructuring. XO needs to emerge from bankruptcy, work to attract new customers, and press forward with its post-restructuring business plan.

As set forth above, Arizona consumers will clearly benefit if XO's reorganization is approved. XO will emerge from bankruptcy in a solid financial position to provide consumers of Arizona with a strong, facilities-based alternative to Qwest. In contrast, if the transaction is not approved, and XO is forced to discontinue service in Arizona, Arizona consumers will suffer real harm. Many of XO's customers will have little choice but to return to Qwest, while others will be forced to quickly and unexpectedly transition to new carriers. In either case, it will be a blow to customer choice and competition in Arizona.

XO respectfully requests that the Commission approved the Application to the extent it believes such approval is necessary and allow XO to continue serving its Arizona customers.

Very truly yours,

Joan S. Burke

JSB:bjw
422655 v1

cc: Mr. Earnest Johnson
Ms. Marta Kalleberg
Mr. Tim Sabo

A


XO Communications

B

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF IN THE MATTER OF THE APPLICATION OF QWEST COMMUNICATIONS CORPORATION FOR APPROVAL OF TRANSFER OF CERTIFICATES OF AUTHORITY IN ASSOCIATION WITH INTERNAL CORPORATE RESTRUCTURING.	DOCKET NO. T-02811B-01-0456 DOCKET NO. T-01051B-01-0456 DECISION NO. 64654 **ORDER**

BY THE COMMISSION:

On June 4, 2001, Qwest Communications Corporation ("QCC"), its subsidiary Phoenix Networks, Inc., dba Phoenix Telcom, Inc. and its affiliates LCI International Telecom Corp. dba Qwest Communications Services and USLD Communications, Inc. (collectively, "Applicants") filed a joint application ("Application") with the Arizona Corporation Commission ("Commission") for approval of transfer of Certificates of Convenience and Necessity ("CC&Ns"), assets, and customers in association with internal corporate restructuring. The Application also requested Commission authority, to the extent required, for certain mergers associated with Applicants' internal corporate restructuring; that the Commission deem inapplicable or waive any applicable statutory or regulatory subscriber authorization provisions regarding individual customer consent to the assignment of accounts in connection with the restructuring; and that the Commission reaffirm the limited waiver of the Commission's Affiliated Interests Rules ("Rules") previously granted by the Commission in Decision No. 58087 (November 23, 1992).

A public hearing was held on this matter at the Commission's offices in Phoenix, Arizona on October 18, 2001.

On December 7, 2001, the Commission issued Decision No. 64249 in this docket. Decision No. 64249 did not grant Applicants' request for a reaffirmation of the limited waiver of the Commission's Affiliated Interests Rules previously granted by the Commission in Decision No. 58087. Instead, Decision No. 64249 directed the Commission's Utilities Division Staff ("Staff") to review and analyze the purpose of and requirements of the limited waiver granted in Decision No.

58087 (November 23, 1992) and to provide the Commission with an analysis regarding whether the limited waiver of A.A.C. R14-2-803 granted in Decision No. 58087 to US WEST Communications, Inc. is appropriate for Qwest Communications International, Inc. and its affiliates in light of the fact that Qwest Corporation intends to commence provision of competitive interLATA services through its affiliate Qwest Communications Corporation at such time that Qwest Communications International, Inc. and its affiliates receive authorization to provide interLATA services pursuant to Section 271 of the Telecommunications Act of 1996.

On January 2, 2002, Staff filed a Staff Report in this docket in which it provided the Commission with the analysis required by Decision No. 64249, and a recommendation, based on that analysis, that the Commission grant the requested relief.

On January 9, 2002, QCC filed in this docket a Notice of Consummation of Merger. By that filing, Applicants provided the Commission with formal notification that the mergers approved by Decision No. 64249 were consummated as of December 31, 2001.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. QCC is a direct, wholly-owned subsidiary of Qwest Services Corporation, which, in turn, is a direct, wholly-owned subsidiary of Qwest Communications International, Inc., the stock of which is publicly traded on the New York Stock Exchange.[1] Pursuant to Commission Decision No. 60898 (May 22, 1998), QCC holds a CC&N in Arizona authorizing it to provide resold interLATA and intraLATA services except for local exchange services.

2. Qwest Corporation is an affiliate of QCC. Qwest Corporation provides local exchange service to over 3.0 million access lines in Arizona.

3. The Commission issued Decision No. 64249 in Docket No. T-02811B-01-0456 on December 7, 2001.

[1] Prior to the merger of Qwest Communications International Inc. and U S WEST, Inc., Qwest Services Corporation was known as Qwest Corporation.

4. Decision No. 64249 authorized the requested asset transfers.

5. Decision No. 64249 cancelled the tariffs of Phoenix Networks, Inc., dba Phoenix Telcom, Inc., LCI International Telecom Corp. dba Qwest Communications Services, and QCC.

6. Decision No. 64249 requires QCC to file a new tariff in Docket No. T-02811B-01-0895. QCC's application for amendment of its CC&N is currently pending in that docket.

7. Decision No. 64249 neither granted nor denied QCC's request for a "reaffirmation" of the limited waiver of the Commission's Affiliated Interests Rules previously granted by the Commission to U S West Communications, Inc. in Decision No. 58087.

8. Decision No. 64249 directed Staff to review and analyze the purpose of and requirements of the limited waiver granted in Decision No. 58087 and to provide the Commission with an analysis regarding whether the limited waiver of A.A.C. R14-2-803 granted in Decision No. 58087 to US WEST Communications, Inc. is appropriate for Qwest Communications International, Inc. and its affiliates in light of the fact that Qwest Corporation intends to commence provision of competitive interLATA services through its affiliate QCC at such time that Qwest Communications International, Inc. and its affiliates receive authorization to provide interLATA services pursuant to Section 271 of the Telecommunications Act of 1996.

9. On January 9, 2002, QCC filed in this docket a Notice of Consummation of Merger to formally notify the Commission that the mergers approved by Decision No. 64249 were consummated as of December 31, 2001.

10. On January 2, 2002, Staff filed a Staff Report in this docket. The Staff Report included the review and analysis directed by Decision No. 64249.

11. Decision No. 58087 granted to US West Communications, Inc. ("USWCI") a limited waiver of A.A.C. R14-2-803.

12. Under the limited waiver granted in Decision No. 58087, USWCI, its parent US WEST, Inc. ("USWI"), and all affiliates of USWCI not regulated by the Commission were required to file a notice of intent to organize or reorganize a public utility holding company only for those organizations or reorganizations which were likely to: 1) result in increased capital costs to USWCI; 2) result in additional costs allocated to the Arizona jurisdiction; or 3) result in a reduction of

USWCI's net operating income. No cumulative threshold or "exempt" amount applied to any organization or reorganization planned by USWCI, its parent USWI, or any affiliate of USWCI that would result in any or all of the three impacts listed above.

13. Decision No. 58087 required USWCI to file annually, at the time it provided the information required by A.A.C. R14-2-805, an affidavit from its Chief Executive Officer which listed the transactions for which USWCI, its parent USWI or any affiliate of USWCI not regulated by the Commission, had not filed a notice of intent pursuant to the waiver granted, and which certified that such transactions would not result in either increased capital costs to USWCI, additional costs being allocated to the Arizona jurisdiction, or a reduction of USWCI's net operating income.

14. USWCI became Qwest Corporation on September 18, 2000.

15. Decision No. 58087 did not grant a waiver of A.A.C. R14-2-805.

16. Qwest Communications International, Inc. ("QCII") is the holding company and ultimate parent of several entities, including Qwest Corporation and QCC. QCII is the counterpart of the former USWI.

17. In its Staff Report, Staff states that QCII entities are divested and formed to suit the QCII organizational goals, and that the formation and divestiture of QCII entities, or "organizations and reorganizations" can be a common occurrence.

18. In its Staff Report, Staff states that the partial waiver of the Rules granted to USWCI and its affiliates in Decision No. 58087 has served as a safety net through which transactions inconsequential to Arizona have passed, while larger transactions with more significant consequences to the Arizona jurisdiction have been processed. Staff listed several transactions that have required Commission approval under the limited waiver. These transactions include the USWI acquisition of a partnership interest in Time Warner Entertainment, L.P., the divestiture of USWCI's interest in Bell Communications Research, Inc., and the separation of the U S WEST Communications Group from U S. WEST Media Group.

19. Because Decision No. 58087 did not grant a waiver of A.A.C. R14-2-804, reaffirmation of the waiver granted in that Decision will not preclude Commission oversight of any future financial transactions between Qwest Corporation and any prospective affiliated competitive

interLATA telecommunications service provider, such as QCC.

20. Decision No. 58087 did not grant a waiver of A.A.C. R14-2-805, which requires all public utility holding companies and Class A public utilities in Arizona to file their diversification plans annually, along with other information, including, but not limited to, financial statements for each subsidiary, a description of the plans for the utility's subsidiaries to change business activities, an assessment of the effect of planned affiliated activities on the utility's capital structure, the bases upon which the holding company allocates costs, the dollar amount transferred between the utility and each affiliate, and most contracts between affiliates and the utility.

21. Staff indicates that the restrictions and requirements that the Telecommunications Act of 1996 ("Act") sets in place concerning Bell Operating Companies ("BOCs"), such as Qwest Corporation, and their transactions with affiliates that provide competitive services, provide a layer of oversight in addition to the Rules. Section 272 of the Act will require Qwest Corporation and its competitive in-region interLATA telecommunications services provider, or "Section 272 affiliate" to keep separate books, records and accounts, and to have separate officers, directors and employees. Section 272 of the Act will also require that all transactions between the entities are arms-length transactions. In addition, the Act prohibits a Section 272 affiliate from obtaining credit under any arrangement that would give a creditor recourse to the assets of a BOC such as Qwest Corporation.

22. Staff explained in the Staff Report that under the Act, a BOC with Section 272 affiliates is required to obtain and pay for a joint Federal/State audit every two years conducted by an independent auditor to determine whether the BOC has complied with Section 272 of the Act, and that the results of the audit must be submitted to the Federal Communications Commission ("FCC") and the State commission of each state in which service is provided.

23. The Staff Report pointed out that in a Report and Order released on December 24, 1996, the FCC adopted accounting safeguards related to the Act. Staff stated that those safeguards prescribe how incumbent local exchange carriers such as Qwest Corporation must account for transactions with affiliates, and how costs incurred in the provision of both regulated telecommunications services and nonregulated services are allocated.

24. Staff believes that the previous waiver granted to USWCI in Decision 58087 has

provided adequate protection of Arizona ratepayers from costs related to affiliates. Staff also believes that in the event QCII and its affiliates receive approval to provide in-region interLATA service in Arizona through a Section 272 affiliate, that Section 272 of the Telecommunications Act of 1996 will provide additional protection.

25. Staff recommends that Decision No. 58087 be upheld and applied to QCC and its affiliates in its entirety.

CONCLUSIONS OF LAW

1. Qwest Communications Corporation and Qwest Corporation are public service corporations within the meaning of Article XV of the Arizona Constitution.

2. The Commission has jurisdiction over this matter and has authority to issue this Order pursuant to A.A.C. R14-2-801 *et seq.*

3. Staff's recommendations are reasonable and should be adopted.

4. Qwest Communications Corporation's request for a reaffirmation of the limited waiver of the Commission's Affiliated Interests Rules previously granted by the Commission in Decision No. 58087 should be granted.

5. As the successor to USWCI, Qwest Corporation should be required to make the annual filings with the Commission that Decision No. 58087 required of USWCI.

ORDER

IT IS THEREFORE ORDERED that the limited waiver of the Commission's Affiliated Interests Rules previously granted to US WEST Communications, Inc. by Commission Decision No. 58087 (November 23, 1992) is hereby reaffirmed to apply in its entirety to Qwest Communications Corporation, Qwest Corporation, their affiliates, and their parent Qwest Communications International, Inc. as described below.

IT IS FURTHER ORDERED that Qwest Communications Corporation, Qwest Corporation, their affiliates, and their parent Qwest Communications International, Inc. are hereby granted a limited waiver of A.A.C. R14-2-803, subject to the conditions described below.

IT IS FURTHER ORDERED that Qwest Communications Corporation, Qwest Corporation, their affiliates, and their parent Qwest Communications International, Inc. are required to file a notice

of intent to organize or reorganize a public utility holding company only for those organizations or reorganizations that are likely to: 1) result in increased capital costs to Qwest Corporation; 2) result in additional costs allocated to the Arizona jurisdiction; or 3) result in a reduction of Qwest Corporation's net operating income. No cumulative threshold or "exempt" amount shall apply to any organization or reorganization planned by Qwest Corporation, Qwest Communications Corporation, their parent Qwest Communications International, Inc., or any of their affiliates, that would result in any or all of the three impacts listed above.

IT IS FURTHER ORDERED that Qwest Corporation shall file annually, at the time it provides the information required by A.A.C. R14-2-805, an affidavit from its Chief Executive Officer that lists the transactions for which Qwest Corporation, Qwest Communications Corporation, their parent Qwest Communications International, Inc., or any of their affiliates, has not filed a notice of intent pursuant to the waiver granted herein, and which certifies that such transactions will not result in either increased capital costs to Qwest Corporation, additional costs being allocated to the Arizona jurisdiction, or a reduction of Qwest Corporation's net operating income.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 25TH day of MARCH, 2002.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____
TW:dap

SERVICE LIST FOR: QWEST COMMUNICATIONS CORPORATION and QWEST CORPORATION

DOCKET NO.: T-02811B-01-0456 and T-01051B-01-0456

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BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
DALE H. MORGAN
COMMISSIONER

IN THE MATTER OF AN APPLICATION BY U S WEST COMMUNICATIONS, INC. FOR A LIMITED WAIVER OF COMPLIANCE WITH RULES RELATING TO AFFILIATED INTERESTS.

DOCKET NO. E-1051-92-191

DECISION NO. 58087

ORDER

Open Meeting
November 23, 1992
Phoenix, Arizona

FINDINGS OF FACT

1. On July 7, 1992, U S WEST Communications, Inc. ("USWCI") filed a verified application for a waiver of compliance with A.A.C. R14-2-803 and -805[1], for its parent U S WEST, Inc., and all affiliates of USWCI. USWCI requested a waiver under the provisions of R14-2-806, which specifically allows affected entities to request waivers from all or portions of the Affiliated Interest Rules.

2. The rules were adopted by the Arizona Corporation Commission ("Commission") on March 14, 1990, in Decision No. 56844, but that decision was stayed on April 26, 1990. Decision No. 56890.

3. On November 3, 1992, the Commission lifted the stay of Decision No. 56844, and made the Affiliated Interest Rules effective for USWCI on December 1, 1992. Decision No. 58063. With

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[1] A.A.C. R14-2-801 through -806 will be referred to hereinafter as the "Affiliated Interest Rules" or "Rules".

the exception of certain aspects of two of the rules, all of the Affiliated Interest Rules will apply to USWCI on that date.

4. USWCI has avowed in its application that, in order to comply with the requirements of A.A.C. R14-2-803, it will be required to file notices of intent and seek Commission approval of numerous transactions which may have no significant effect upon, or relationship to, either USWCI or the State of Arizona.

5. U S WEST, Inc. ("USWI"), USWCI's parent and affiliate (as defined by A.A.C. R14-2-801.1.), has over 70 subsidiaries, some of which have other affiliated interests, and USWCI, itself, has investments in 24 affiliates. The creation, deletion and modification of the structure and interest in those affiliates is a common occurrence, which often has no effect on Arizona operations.

6. Staff recommends that a waiver to R14-2-803 be granted with certain important exceptions identified below. This recommendation is intended to ensure that notices of intent regarding occurrences which have little or no relevance to Arizona operations will not be required, yet will provide protection to Arizona ratepayers from unreasonable capital costs, and unreasonable allocated costs.

7. Staff recommends that USWCI, its parent USWI, and all affiliates of USWCI not regulated by the Commission, be required to file a notice of intent to organize or reorganize a public utility holding company only for those organizations or reorganizations which are likely to: 1) result in increased capital costs to USWCI; 2) result in additional costs allocated to the Arizona jurisdiction; or 3) result in a reduction of USWCI's net operating

income. Staff recommends that no cumulative threshold or "exempt" amount apply to any organization or reorganization planned by USWCI, its parent USWI, or any affiliate of USWCI which would result in any or all of the three impacts listed above.

8. Staff further recommends that USWCI file annually, at the time USCWI provides the information required by R14-2-805, an affidavit from its Chief Executive Officer which lists the transactions for which USWCI, its parent USWI or any affiliate of USWCI not regulated by the Commission, has not filed a notice of intent pursuant to the waiver granted herein, and which certifies that such transactions will not result in either increased capital costs to USWCI, additional costs being allocated to the Arizona jurisdiction, or a reduction of USWCI's net operating income.

9. Staff believes that its recommendation concerning a limited waiver of the requirements of A.A.C. R14-2-803 will serve the ratepayers, the Commission and USWCI well by maintaining Commission oversight of any transaction that might negatively affect Arizona operations, while removing the possibly onerous filing requirement burden from USWCI.

10. USWCI's application also requests a waiver of compliance with A.A.C. R14-2-805, which requires USWCI and its parent USWI to annually file certain information with the Commission, which information includes various facets of USWCI's and USWI's relationships with their affiliates.

11. USWCI indicates in its application that much of the information required to be filed by A.A.C. R14-2-805 regarding diversification is also available in its annual filings with the Securities and Exchange Commission; that diversification activities

of U S WEST are a small part of its overall operations; and that Arizona operations comprise only 8.5% of USWCI's operations. The implication is that because USWCI has determined that the risk of adverse impact of diversification of both U S WEST, Inc. and USWCI upon Arizona operations is small, USWCI does not need to comply with A.A.C. R14-2-805.

12. Staff disagrees with USWCI's position and recommends that a waiver to A.A.C. R14-2-805 not be approved for the following reasons: 1) Staff has already recommended waiver of compliance with most of A.A.C. R14-2-803 and feels that compliance with A.A.C. R14-2-805 will serve as a "safety net" through which potentially hazardous transactions which would have been reported in R14-2-803 will be reported; and 2) regarding USWCI's contention that the information sought under R14-2-805 is available from other regulatory bodies, it is doubtful the information will appear in a format similar to the format Staff is currently compiling for compliance with this rule, which will be a standardized format for all reporting entities in order to facilitate Staff analysis.

CONCLUSIONS OF LAW

1. USWCI, is a public service corporation within the meaning of Article 15 of the Arizona Constitution, and Title 40 of the Arizona Revised Statutes.

2. The Commission has jurisdiction over this matter and has the authority to issue this order.

3. Staff's recommendations are reasonable and should be adopted.

. . .

. . .

4. USWCI's application for a waiver of A.A.C. R14-2-803 should be granted subject to Staff's recommendations contained in Findings of Fact No. 7 and 8.

5. USWCI's application for a waiver of A.A.C. R14-2-805 should be denied.

ORDER

THEREFORE IT IS ORDERED that the application of USWI for a waiver of A.A.C. R14-2-803 be and hereby is granted, subject to the conditions described below.

IT IS FURTHER ORDERED that USWCI, its parent USWI, and all affiliates of USWCI not regulated by the Commission, be required to file a notice of intent to organize or reorganize a public utility holding company only for those organizations or reorganizations which are likely to: 1) result in increased capital costs to USWCI; 2) result in additional costs allocated to the Arizona jurisdiction; or 3) result in a reduction of USWCI's net operating income. No cumulative threshold or "exempt" amount shall apply to any organization or reorganization planned by USWCI, its parent USWI, or any affiliate of USWCI which would result in any or all of the three impacts listed above.

IT IS FURTHER ORDERED that USWCI file annually, at the time USCWI provides the information required by R14-2-805, an affidavit from its Chief Executive Officer which lists the transactions for which USWCI, its parent USWI or any affiliate of USWCI not regulated by the Commission, has not filed a notice of intent pursuant to the waiver granted herein, and which certifies that such transactions will not result in either increased capital

. . .

costs to USWCI, additional costs being allocated to the Arizona jurisdiction, or a reduction of USWCI's net operating income.

IT IS FURTHER ORDERED that USWCI's application for a waiver of A.A.C. R14-2-805 be and hereby is denied.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, JAMES MATTHEWS, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 23 day of November, 1992.

JAMES MATTHEWS
Executive Secretary

DISSENT_____

C

HIGH RIVER LIMITED PARTNERSHIP
1 Wall Street Court
Suite 980
New York, New York 10005

December 23, 2002

Commissioner Marc Spitzer
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007-2996

Re: Application for Approval of the Transfer of Control of XO Long Distance Services, Inc. and XO Arizona, Inc. (Docket Nos. T-04150A-02-0814, T-03775A-02-0814, T-03601A-02-0814)

Dear Commissioner Spitzer:

We are writing in connection with the pending application before the Arizona Corporation Commission regarding the proposed restructuring of XO Communications, Inc. ("XO"). Under the proposed restructuring, High River Limited Partnership, a partnership controlled by Carl Icahn, would acquire a controlling interest in XO and, through XO, a controlling interest in XO's Arizona-certificated subsidiaries. The purpose of this letter is to clarify certain matters regarding the intention of Mr. Icahn with respect to his investment in XO and to provide additional information regarding previous Icahn investments.

In response to particular concerns you raised at the public open meeting on December 17, 2002, we assure you that Mr. Icahn is very enthusiastic about the future of XO and believes XO can play a leading role in bringing the benefits of competition to telecommunications consumers in Arizona. He has already met with employees of XO and is looking forward to working with them. Mr. Icahn has been an approved owner in one of the most highly regulated and carefully monitored industries in the country, the casino gaming industry. He is an accomplished business person with a wide breath of experiences in various industries. Mr. Icahn's ownership and reinvigoration of XO is clearly in the public interest and is in the interest of current XO customers.

The bulk of Mr. Icahn's $500 investment in XO was completed by buying secured debt from commercial banks and other very large and sophisticated institutions. Mr. Icahn will protect his $500 million investment in XO by ensuring that XO retains knowledgeable executives to run the business. You can be assured that XO under Mr. Icahn's control will give service to its customers the highest priority, as customer loyalty and satisfaction must be a key

hallmark of XO's strategy if it is to be successful in the current extremely competitive telecommunications environment.

Regarding your concerns with respect to the TWA ticket agreement, we advise you that in connection with TWA's bankruptcy, Mr. Icahn loaned $200 million to TWA, to be paid back within 2 years. When TWA failed to make those payments, Mr. Icahn and TWA agreed to an arrangement whereby Mr. Icahn would sell TWA tickets, with the proceeds of those sales being used to reduce the loan balance and allow Mr. Icahn to recoup his costs. Mr. Icahn built a company to sell those tickets but ultimately lost millions when TWA failed again in 2001. Mr. Icahn believes that, given the known pressures on the airline industry for many years, TWA performed well under his stewardship. From the time that Mr. Icahn acquired control of TWA, the company prospered and its stock price increased by 300% through the date that it became a private company. Unfortunately, the airline was not able to withstand severe business reversals following the Desert Storm military campaign and related matters occurring in 1991 that negatively impacted the international travel industry. However, as noted above, even after TWA went into bankruptcy in 1992, Mr. Icahn loaned the company $200 million to keep it afloat. It should be noted that Mr. Icahn was able to keep the airline flying through a difficult business climate that resulted in the closing of competitors such as Eastern, Braniff and Pan American, all of which had stronger balance sheets than TWA at the time Mr. Icahn took control of that airline.

You are further informed, in response to issues raised during the recent open meeting, that, although Mr. Icahn has paid nearly $500 million for his investment in XO, the deal does not provide for any payments to him, other than the interest that would be paid to any other holder of the XO debt, which is expected to be paid-in-kind for many years. In response to inquiries relating to possible liquidation scenarios, even if Mr. Icahn desired to liquidate XO, which he does not, this concern is misplaced as the market has made it abundantly clear that the liquidation values of telecommunications companies such as XO are a small fraction of their values as going concerns.

Mr. Icahn's career spans the past 40 years. In that time Mr. Icahn has been an employee and manager of broker-dealer firms as well as the owner of his own brokerage firm, Icahn & Co. He has acquired ownership or control of various companies and acted as an activist investor during a time of significant change in United States capital markets. Mr. Icahn's companies currently employ over 26,000 people, making him one of the largest individual employers in the United States. Those companies operate almost exclusively in the United States.

Mr. Icahn has been involved in a number of heated battles for corporate control. As part of their defensive tactics, at times those managements and their public relations firms have attempted to attack Mr. Icahn, labeling him with names such as "corporate raider." However, as Mr. Icahn has been saying for years and as the public is now painfully aware, the real "raiding" of corporate assets in U.S. public companies has been done by the very executive officers whose job it was to safeguard those assets. Mr. Icahn has made significant investments to expand the companies in which he has an interest and does not take any compensation from the public companies that he controls. He has never dismantled a company of which he has taken control.

In this regard we are providing you with the following information regarding every major company in which Mr. Icahn has held a controlling interest:

ACF Industries In 1984, Mr. Icahn's affiliated companies acquired ACF Industries. ACF is a leading manufacturer and lessor of railcars. The company was established in the mid-1860s. Today, ACF and its affiliated companies have approximately 17 facilities located in nine states, and employ approximately 1,800 individuals. Over the past 18 years, ACF and its affiliated companies have invested an average of approximately $70 million annually in ACF's leased fleet, and Mr. Icahn has invested approximately $100 million in ACF's manufacturing facilities, creating approximately 1,000 new jobs in communities such as Paragould and Marmaduke, Arkansas and Kennett, Missouri. Mr. Icahn has invested approximately $1.5 billion in the company since 1985.

American Real Estate Partners L.P. In 1991, Mr. Icahn's affiliated companies acquired a controlling interest in AREP, a public company the primary business of which is to own, manage, finance, develop and invest in real property. Since that time AREP has grown from a company with 16 employees and partners' equity of approximately $226 million to a company with approximately 500 employees and partners' equity of approximately $1.17 billion.

Gaming Properties Companies affiliated with Mr. Icahn own or control three casino properties located in Las Vegas, Nevada and one casino property located in Atlantic City, New Jersey. Those companies currently employ an aggregate of approximately 7,600 persons. Recently one of the Las Vegas properties expanded its facilities by adding a 1000 room hotel tower. When it appeared that outside bank financing would not be available for the expansion, Mr. Icahn's affiliated companies provided the $73 million necessary to fund the expansion. The addition of that tower alone added approximately 240 employees to the property's payroll. As with the XO transaction, many of these properties were acquired out of bankruptcy.

Mr. Icahn's activities regarding TWA are discussed above.

While none of the companies mentioned above provide telecommunications services, they are all nonetheless illustrative of the significant commitment of Mr. Icahn to his companies and to turning around financially-troubled companies and placing them in a position to increase their competitiveness and contribute significantly to the overall economy. The experiences of these companies demonstrate that, instead of "raiding" companies of their assets, Mr. Icahn has achieved success as an investor by working diligently and deliberately to improve their financial condition in a way that benefits the communities in which they are located. Mr. Icahn believes that similar benefits can occur as a result of his obtaining a controlling interest in XO.

Mr. Icahn's activism as a shareholder has also worked to the benefit of many of the companies in which he has become interested but where control was not obtained. The following summarizes all major transactions in which he played an activist role. These transactions resulted in substantial increased value for company shareholders and protected and

enhanced solid business operations, thereby benefiting employees, customers and other constituencies.

RJR Nabisco Mr. Icahn conducted a four-year campaign with respect to RJR Nabisco seeking to help the Company to obtain a valuation of its overall business without being totally eclipsed by the negative perception of its tobacco business. Under pressure from Mr. Icahn, and as a result of his persistent urging, the valuable food business was finally separated from the tobacco business, thereby unlocking the intrinsic value of those assets causing the share price to increase well over 300%. Additionally, these actions allowed Nabisco to expand its business, which created more employment.

Texaco At the time of Mr. Icahn's investment, Texaco was the subject of a $10 billion judgment in favor of Pennzoil that threatened to destroy Texaco. In connection with his investment in Texaco, Mr. Icahn was credited by the company's CEO with brokering the settlement of that judgment. Mr. Icahn's action thus allowed Texaco to survive as a viable business and greatly enhanced shareholder value in the process.

U.S. Steel Mr. Icahn sought through discussions with management over a four year period to achieve a separation of Marathon Oil. Through his activism that separation was ultimately achieved to the benefit of stockholders and other constituencies.

In our view, if there had been greater shareholder activism such as Mr. Icahn's in the 1990's, the problems now evident in companies like Enron, Tyco, WorldCom and Global Crossing might have been avoided.

Mr. Icahn currently controls a wide array of businesses, all of which operate almost exclusively in the United States, including highly regulated businesses such as casinos, which continue to expand their operations and employment rolls and benefit the communities in which they operate and the customers that they serve, and which employ thousands of individuals throughout the United States.

Mr. Icahn's substantial business successes have been characterized, over the long-term, by his steadfast stewardship of the companies he controls and his ongoing investment in and expansion of those companies.

Although Mr. Icahn is extremely enthusiastic about the future prospects of XO, no other party has come forward with an alternative reorganization plan that places XO on a financial footing that allows it to continue as a facilities-based provider. XO has been operating in bankruptcy since June 17, 2002. An alternative plan of reorganization involving Forstmann Little & Co. and Telefonos de Mexico, S.A. de C.V. could not be consummated. The longer XO languishes in bankruptcy, the more difficult it will be for XO to maintain its existing customer relationships and ability to aggressively compete against other telecommunications providers.

Unlike some other competitive telecommunications carriers that have been required to liquidate their assets for lack of investor interest, XO, as a result of Mr. Icahn's interest, is poised to emerge from bankruptcy with an opportunity to attract additional customers and generate new employment and investment in the state of Arizona. Mr. Icahn's long and distinguished record demonstrates that he is uniquely qualified to assist in accomplishing these goals.

Very truly yours,

High River Limited Partnership

By: Barberry Corp., its general partner

By: _____
Name: Edward E. Mattner
Title: Authorized Signatory

cc: Chairman William Mundell
Commissioner Jim Irvin
Tim Sabo, Legal Division
Marta Kalleberg, Utilities Division